Study H-858 July 13, 2011

Memorandum 2011-29

Common Interest Development Law: Commercial and Industrial Subdivisions

This memorandum commences a study of the scope of application of Business and Professions Code Section 11010.3 and Civil Code Section 1373.

Those two sections have an intertwined history and use nearly identical language in defining the class of property developments that they affect. Each of the provisions establishes regulatory exemptions for developments that are "limited to industrial or commercial uses" by zoning or by a recorded declaration of covenants, conditions, and restrictions:

- Section 11010.3 exempts commercial and industrial *subdivisions* from the requirements of the Subdivided Lands Act (Bus. & Prof. Code § 11000 *et seq.*).
- Section 1373 exempts commercial and industrial *common interest developments* (hereafter "CIDs") from specified provisions of the Davis-Stirling Common Interest Development Act (Civ. Code § 1350 *et seq.*; hereafter "Davis-Stirling Act").

Note that a CID is a type of subdivision, for the purposes of the Subdivided Lands Act. See Bus. & Prof. Code § 11004.5.

The Commission is currently conducting a separate study of Section 1373, to determine which provisions of the Davis-Stirling Act should be applicable to commercial and industrial CIDs. See Study H-856.

In that separate study, the Commission received public comment from a group of commercial CID attorneys and managers (the "Commercial CID Stakeholder Group"). The group proposes making certain revisions to the language used by Section 1373 to describe the exempted class of CIDs. The concern was that some unusual types of CIDs do not fit cleanly within the classification established by the existing language. See Memorandum 2011-21 and its First and Second Supplements.

Because of the parallelism between Sections 1373 and 11010.3, the Commission decided it would be best to study the provisions in tandem, to determine whether the language in both sections could be improved without

creating problematic incongruities between the two affected bodies of law. See Minutes (June 2011), p. 4.

This memorandum begins with a discussion of the purpose and effect of the Subdivided Lands Act. It then examines the legislative history of the exemption language that is common to Sections 1373 and 11010.3. It concludes by discussing the issues raised by the Commercial CID Stakeholder Group, to determine whether the policy purposes of Sections 1373 and 11010.3 would support making changes of the type proposed by the group.

The following materials are attached as an Exhibit:

SUBDIVIDED LANDS ACT

The Subdivided Lands Act is a consumer protection statute that regulates the sale or lease of lots or parcels within a "subdivision" or "subdivided lands." Bus. & Prof. Code §§ 11000-11200.

As a general rule, the synonymous terms "subdivision" and "subdivided lands" mean

> improved or unimproved land or lands, wherever situated within California, divided or proposed to be divided for the purpose of sale or lease or financing, whether immediate or future, into five or more lots or parcels.

Bus. & Prof. Code § 11000(a). As noted above, CIDs are expressly included in the definition of "subdivision" or "subdivided lands," so both the Davis-Stirling Act and Subdivided Lands Act apply to CIDs. See Bus. & Prof. Code § 11004.5.

There are a number of exemptions to the application of the Subdivided Lands Act, including the exemption of commercial and industrial subdivisions that is the focus of this study. Those exemptions are discussed below.

Purpose of Subdivided Lands Act

In upholding the validity of the Subdivided Lands Act as a proper exercise of the state's police power, the California Supreme Court stated:

> The object of the present law, prevention of fraud and sharp practices in a type of real estate transaction peculiarly open to such abuses, is obviously legitimate; and the method, involving investigation and disclosure of certain essential facts, and a protection for the innocent purchaser against loss of his land by foreclosure of the underlying mortgage, is perfectly reasonable.

In re *Sidebotham*, 12 Cal. 2d 434, 436, 85 P.2d 453 (1938). See also *Westbrook v. Summerfield*, 154 Cal. App. 2d 761, 766, 316 P.2d 691 (1957) ("purpose of Subdivided Lands Act is to protect individual members of the public who purchase lots or homes from subdividers and to make sure that full information will be given to all purchasers concerning public utility functions and other essential facts with reference to the land."); *Property Owners of Whispering Palms, Inc. v. Court of Appeal*, 132 Cal. App. 4th 666, 33 Cal. Rptr. 3d 845 (2005) ("The Act is a consumer protection statute intended primarily to prevent 'fraud and sharp practices' by requiring disclosure of all relevant information to potential purchasers and lessees….").

The Subdivided Lands Act achieves those purposes by imposing a number of procedural and substantive requirements that must be satisfied before a subdivider can sell or lease lots or parcels within a subdivision. Those substantive and procedural requirements are summarized below.

Procedural Requirements of Subdivided Lands Act

As a general rule, a person may not sell or lease (or offer for sale or lease) any lots or parcels within a subdivision, without first obtaining a "public report" from the Real Estate Commissioner (the "Commissioner"). See Bus. & Prof. Code § 11018.2.

To obtain a public report, the subdivider must submit a notice of intention and a questionnaire to the Commissioner. Bus. & Prof. Code § 11010(a).

Content of Notice of Intention

The notice of intention must include all of the following information about the subdivision and the proposed lease or sale of interests within the subdivision:

> (1) The name and address of the owner.
> (2) The name and address of the subdivider.
> (3) The legal description and area of lands.
> (4) A true statement of the condition of the title to the land, particularly including all encumbrances thereon.

(5) A true statement of the terms and conditions on which it is intended to dispose of the land, together with copies of any contracts intended to be used.

(6) A true statement of the provisions, if any, that have been made for public utilities in the proposed subdivision, including water, electricity, gas, telephone, and sewerage facilities. For subdivided lands that were subject to the imposition of a condition pursuant to subdivision (b) of Section 66473.7 of the Government Code, the true statement of the provisions made for water shall be satisfied by submitting a copy of the written verification of the available water supply obtained pursuant to Section 66473.7 of the Government Code.

(7) A true statement of the use or uses for which the proposed subdivision will be offered.

(8) A true statement of the provisions, if any, limiting the use or occupancy of the parcels in the subdivision.

(9) A true statement of the amount of indebtedness that is a lien upon the subdivision or any part thereof, and that was incurred to pay for the construction of any onsite or offsite improvement, or any community or recreational facility.

(10) A true statement or reasonable estimate, if applicable, of the amount of any indebtedness which has been or is proposed to be incurred by an existing or proposed special district, entity, taxing area, assessment district, or community facilities district within the boundaries of which, the subdivision, or any part thereof, is located, and that is to pay for the construction or installation of any improvement or to furnish community or recreational facilities to that subdivision, and which amounts are to be obtained by ad valorem tax or assessment, or by a special assessment or tax upon the subdivision, or any part thereof.

(11) A notice pursuant to Section 1102.6c of the Civil Code.

(12) (A) As to each school district serving the subdivision, a statement from the appropriate district that indicates the location of each high school, junior high school, and elementary school serving the subdivision, or documentation that a statement to that effect has been requested from the appropriate school district.

(B) In the event that, as of the date the notice of intention and application for issuance of a public report are otherwise deemed to be qualitatively and substantially complete pursuant to Section 11010.2, the statement described in subparagraph (A) has not been provided by any school district serving the subdivision, the person who filed the notice of intention and application for issuance of a public report shall immediately provide the department with the name, address, and telephone number of that district.

(13) (A) The location of all existing airports, and of all proposed airports shown on the general plan of any city or county, located within two statute miles of the subdivision. If the property is located within an airport influence area, the following statement shall be included in the notice of intention:

NOTICE OF AIRPORT IN VICINITY

This property is presently located in the vicinity of an airport, within what is known as an airport influence area. For that reason, the property may be subject to some of the annoyances or inconveniences associated with proximity to airport operations (for example: noise, vibration, or odors). Individual sensitivities to those annoyances, if any, are associated with the property before you complete your purchase and determine whether they are acceptable to you [sic].

(B) For purposes of this section, an "airport influence area," also known as an "airport referral area," is the area in which current or future airport-related noise, overflight, safety, or airspace protection factors may significantly affect land uses or necessitate restrictions on those uses as determined by an airport land use commission.

(14) A true statement, if applicable, referencing any soils or geologic report or soils and geologic reports that have been prepared specifically for the subdivision.

(15) A true statement of whether or not fill is used, or is proposed to be used, in the subdivision and a statement giving the name and the location of the public agency where information concerning soil conditions in the subdivision is available.

(16) On or after July 1, 2005, as to property located within the jurisdiction of the San Francisco Bay Conservation and Development Commission, a statement that the property is so located and the following notice:

NOTICE OF SAN FRANCISCO BAY CONSERVATION AND DEVELOPMENT COMMISSION JURISDICTION

This property is located within the jurisdiction of the San Francisco Bay Conservation and Development Commission. Use and development of property within the commission's jurisdiction may be subject to special regulations, restrictions, and permit requirements. You may wish to investigate and determine whether they are acceptable to you and your intended use of the property before you complete your transaction.

(17) If the property is presently located within one mile of a parcel of real property designated as "Prime Farmland," "Farmland of Statewide Importance," "Unique Farmland," "Farmland of Local Importance," or "Grazing Land" on the most current "Important Farmland Map" issued by the California Department of Conservation, Division of Land Resource Protection, utilizing solely the county-level GIS map data, if any, available on the Farmland Mapping and Monitoring Program Website. If the residential property is within one mile of a designated farmland area, the report shall contain the following notice:

NOTICE OF RIGHT TO FARM

This property is located within one mile of a farm or ranch land designated on the current county-level GIS "Important Farmland Map," issued by the California Department of Conservation, Division of Land Resource Protection. Accordingly, the property may be subject to inconveniences or discomforts resulting from agricultural operations that are a normal and necessary aspect of living in a community with a strong rural character and a healthy agricultural sector. Customary agricultural practices in farm operations may include, but are not limited to, noise, odors, dust, light, insects, the operation of pumps and machinery, the storage and disposal of manure, bee pollination, and the ground or aerial application of fertilizers, pesticides, and herbicides. These agricultural practices may occur at any time during the 24-hour day. Individual sensitivities to those practices can vary from person to person. You may wish to consider the impacts of such agricultural practices before you complete your purchase. Please be advised that you may be barred from obtaining legal remedies against agricultural practices conducted in a manner consistent with proper and accepted customs and standards pursuant to Section 3482.5 of the Civil Code or any pertinent local ordinance.

(18) Any other information that the owner, his or her agent, or the subdivider may desire to present.

Bus. & Prof. Code § 11010(b). **(Note that the airport notice language set out in paragraph (b)(13) appears to be defective. If the Commission decides to propose any reforms in connection with this study, the staff will try to figure out the intended language and prepare a technical revision to correct it.)** See also Bus. & Prof. Code § 11010.05 (special notice for senior citizen housing development). Further application content requirements are set out in Department of Real Estate ("DRE") regulations. See 10 Cal. Code Regs. §§ 2792 (standard subdivision), 2792.1 (CID).

Real Estate Commissioner Review

The Real Estate Commissioner reviews the application to determine whether it is "substantially complete." Bus. & Prof. Code § 11010.2(a)-(c). If the application is not substantially complete, the Commissioner provides notice of the deficiencies (which can then be cured by submission of supplementary material). *Id*.

Once the application is substantially complete, the Commissioner shall conduct an examination of the subdivision and "shall, unless there are grounds for denial, issue to the subdivider a public report authorizing the sale or lease in

this state of the lots or parcels within the subdivision." See Bus. & Prof. Code § 11018.

> The grounds for denial are:
> (a) Failure to comply with any of the provisions in this chapter or the regulations of the commissioner pertaining thereto.
> (b) The sale or lease would constitute misrepresentation to or deceit or fraud of the purchasers or lessees.
> (c) Inability to deliver title or other interest contracted for.
> (d) Inability to demonstrate that adequate financial arrangements have been made for all offsite improvements included in the offering.
> (e) Inability to demonstrate that adequate financial arrangements have been made for any community, recreational or other facilities included in the offering.
> (f) Failure to make a showing that the parcels can be used for the purpose for which they are offered; and in the case of a subdivision being offered for residential purposes failure to make a showing that vehicular access and a source of potable domestic water either is available or will be available.
> (g) Failure to provide in the contract or other writing the use or uses for which the parcels are offered, together with any covenants or conditions relative thereto.
> (h) Agreements or bylaws to provide for management or other services pertaining to common facilities in the offering, which fail to comply with the regulations of the commissioner.
> (i) Failure to demonstrate that adequate financial arrangements have been made for any guaranty or warranty included in the offering.

Id.

Content and Distribution of Public Report

The Commissioner's public report must contain all of the data provided in the subdivider's application. See Bus. & Prof. Code § 11018.

The subdivider is required to provide a copy of the public report to all prospective purchasers, before execution of a binding agreement for the sale or lease of an interest in the subdivision. See Bus. & Prof. Code § 11018.1(a). The public report must also be given to any member of the public on request, and posted at the subdivider's sales office. See Bus. & Prof. Code § 11018.1(b).

If the subdivision is a CID, the subdivider must also provide prospective purchasers a copy of a statutory notice about the CID property form. See Bus. & Prof. Code § 11018.1(c).

Substantive Requirements of Subdivided Lands Act

In addition to the various informational disclosures that are required as part of the notice of intention, a subdivider must also demonstrate compliance with a number of substantive requirements before a public report will issue.

Purchase Money and Deposit Protections

The Subdivided Lands Act includes provisions that restrict a subdivider's access to money advanced by a purchaser or lessee. See Bus. & Prof. Code §§ 11013-11013.4.

> The purpose of these restrictions is to assure that the subdivider will deliver the promised improvements, in the condition as represented, for the price the purchasers agree and expect to pay, and that funds deposited by purchasers will be available for refund if the subdivider fails to deliver the property at closing. These regulations do not address all of the potential abuses by subdividers, but they do restrict some of the most obviously dangerous risks.

Miller, Starr & Regalia, California Real Estate *Subdivision Offerings, Sales, and Leasing* § 25C:33 (2007 update).

Special Requirements for Common Interest Developments

There are special substantive requirements that must be satisfied if a subdivision is a CID. Before issuing a public report for a CID, the Commissioner must find each of the following to be true:

- The subdivider has made reasonable arrangements for the completion of the subdivision and all promised offsite improvements. See Bus. & Prof. Code § 11018.5(a)(1)
- If the CID premises and facilities will not be complete before issuance of the final report, the subdivider has taken one of a range of specified alternative steps to ensure that funds will be available for completion of the improvements, lien-free. See Bus. & Prof. Code § 11018.5(a)(2).
- The instruments used to transfer legal interests to purchasers and lessees are adequate for that purpose. See Bus. & Prof. Code § 11018.5(b).
- After the transfer of title to the first separate interest in the CID, the governing documents last submitted to the Commissioner will be binding on all separate interest owners. See Bus. & Prof. Code § 11018.5(c).

- The subdivider has made reasonable arrangements for the transfer of control of the CID to the owners of the separate interests. See Bus. & Prof. Code § 11018.5(d).
- The subdivider has made reasonable arrangements for the "management, maintenance, preservation, operation, use, right of resale, and control of separate interest and other areas or interest that are subject to the governing documents. See Bus. & Prof. Code § 11018.5(e).

In connection with the last requirement, the Commissioner reviews the proposed governing documents for the CID and assesses their adequacy with respect to the following matters:

- Procedures for calculating and collecting regular assessments from owners to defray expenses attributable to the ownership, operation or furnishing of common interests or to the enjoyment of mutual and reciprocal rights of use. See 10 Cal. Code Reg. § 2792.16.
- Procedures for establishing and collecting special assessments for capital improvements or for other purposes. See 10 Cal. Code Reg. §§ 2792.16, 2792.21.
- Liens upon privately-owned subdivision interests for assessments levied pursuant to the CC&Rs and foreclosure thereof for nonpayment. See 10 Cal. Code Reg. § 2792.16.
- Policies and procedures relating to the disciplining of members for failure to comply with provisions of the governing instruments. See 10 Cal. Code Reg. § 2792.26.
- Creation of a governing body for the association. See 10 Cal. Code Reg. § 2792.21.
- Procedures for the election and removal of governing body members and officers of the association. See 10 Cal. Code Reg. § 2792.19.
- Enumeration of the powers and duties of the governing body and the officers, including any limitations on the authority of the governing body to act without the prior approval of members. See 10 Cal. Code Reg. § 2792.21
- Allocation of voting rights to association members. See 10 Cal. Code Reg. § 2792.18
- Preparation and distribution of the budgets and financial statements of the association. See Civ. Code § 1365.
- Regular and special meetings of association members. See 10 Cal. Code Reg. § 2792.17.
- Regular meetings of the governing body. See 10 Cal. Code Reg. § 2792.20.

- Quorum requirements for meetings of members of the association and of the governing body. See 10 Cal. Code Reg. §§ 2792.17, 2792.20.
- Procedures for proxy voting at members' meetings. See 10 Cal. Code Reg. § 2792.17.
- Policies and procedures governing the inspection of books and records of the association by members. See 10 Cal. Code Reg. § 2792.23.
- Amendment procedures for those provisions of the governing instruments which relate to the ownership, management, and control of the association and the common interests. See 10 Cal. Code Reg. § 2792.24.
- Prohibitions against or restrictions upon the severability of a separately-owned portion from the common interest portion of a subdivision interest.
- Conditions upon which a partition of a condominium project may be had pursuant to Section 1359 of the Civil Code.
- Action to be taken and procedures to be followed in the event of condemnation, destruction or extensive damage to the subdivision interests, including provisions respecting the use and disposition of insurance proceeds or damages payable to the association or to a trustee on behalf of owners on account of condemnation, destruction, or damage.
- Annexation of additional land to the existing development where appropriate. See 10 Cal. Code Reg. § 2792.27.
- Architectural and design control. See 10 Cal. Code Reg. § 2792.28.
- Special provisions for enforcement of financial arrangements by the subdivider to secure performance of his commitment to complete common area improvements. See 10 Cal. Code Reg. § 2792.4.
- Granting of easements or use rights affecting the common areas
- Special provisions authorizing the governing body, subject to compliance with Section 1354 of the Civil Code, to institute, defend, settle or intervene on behalf of the association in litigation, arbitration, mediation, or administrative proceedings in matters pertaining to (A) enforcement of the governing instruments, (B) damage to the common areas, (C) damage to the separate interests which the association is obligated to maintain or repair, or (D) damage to the separate interests that arises out of, or is integrally related to, damage to the common areas or separate interests that the association is obligated to maintain or repair.

See generally DRE Form 648, *Regulation Check Sheet* at pp. 1-3.

Limitation on Amendment of Governing Documents

During the initial period of subdivider control, the governing documents of a CID or a subdivision that consists of undivided interests, cannot be amended without the written consent of the Commissioner. This initial period lasts while the subdivider (or a successor in interest) holds or directly controls one-fourth or more of the votes that may be cast. See Bus. & Prof. Code § 11018.7. The Commissioner shall not consent to an amendment if it would create a new condition or circumstance that would have led to denial of the public report. *Id*.

Exemptions from the Application of the Subdivided Lands Act

This memorandum is primarily focused on the exemption of commercial and industrial CIDs from the Subdivided Lands Act, pursuant to Business and Professions Code Section 11010.3. However, there are other exemptions also worth noting.

The public report process does not apply to any of the following:

- Land that is divided into four or fewer lots or parcels. See Bus. & Prof. Code § 11000(a).
- The leasing of apartments, offices, stores, or similar space within an apartment building, industrial building, commercial building, or mobilehome park (with exceptions for community apartment projects (a type of CID) and for long-term rentals in a mobilehome park). *Id*.
- A subdivision comprised of *undivided* interests, if those interests are held by persons related by blood or marriage or are to be purchased and owned solely by persons who demonstrate to the Commissioner that they are "knowledgeable and experienced investors who comprehend the nature and extent of the risks involved in the ownership of [the] interests." See Bus. & Prof. Code § 11000.1(b)(1)-(2).
- A subdivision comprised of *undivided* interests, if those interests are created by foreclosure sale or court order. See Bus. & Prof. Code § 11000.1(b)(3)-(4).
- A standard subdivision within city limits that consists solely of lots improved with completed residences, so long as specified conditions are met. See Bus. & Prof. Code § 11010.4.
- Land that is divided into parcels of not less than 160 acres in size, if certain stated conditions are met. See Bus. & Prof. Code § 11000(a).
- Land that is offered for sale by a public agency. See Bus. & Prof. Code § 11010.6.

- A transfer of land to a builder or reseller, who then further subdivides the transferred land into five or more lots, parcels, or other interests. Bus. & Prof. Code § 11010.35.
- The sale of a mobilehome park to a tenant-controlled nonprofit corporation. See Bus. & Prof. Code § 11010.8.

HISTORY OF COMMERCIAL AND INDUSTRIAL EXEMPTION LANGUAGE

As noted at the outset, the language used to define the class of commercial and industrial subdivisions that are exempt from the Subdivided Lands Act is substantively identical to the language used to define the class of commercial and industrial CIDs that are exempt from portions of the Davis-Stirling Act.

In each case, the exemption applies to a subdivision that is "limited to commercial or industrial uses" by zoning or by a declaration of covenants, conditions, and restrictions that is recorded in each county in which the subdivision is located. *Compare* Bus. & Prof. Code § 11010.3 *with* Civ. Code § 1373.

History of the Commercial and Industrial Exemption Language

The earliest version of the commercial and industrial exemption language was amended into Business and Professions Code Section 11018.2, in 1969. Prior to that amendment, Section 11018.2 stated the basic prohibition at the heart of the Subdivided Lands Act:

> No person shall sell or lease, or offer for sale or lease in this State any lots or parcels in a subdivision without first obtaining a public report from the Commissioner.

See 1963 Cal. Stat. ch. 927 (adding Section 11018.2).

The 1969 amendment created the first version of the commercial and industrial exemption. The amendment is set out below (with underscore showing changes):

> No person shall sell or lease, or offer for sale or lease in this State any lots or parcels in a subdivision without first obtaining a public report from the Commissioner, except that the Commissioner shall waive the provisions of this section, in writing, for expressly zoned industrial subdivisions which are limited in use to industrial purposes and commercial leases of parcels in a shopping center.
>
> As used in this section, "shopping center" means a group of commercial establishments, planned, developed, owned or

managed as a unit, with offstreet parking provided on the property of the shopping center.

See 1969 Cal. Stat. ch. 373.

In 1974, the language was amended again, to replace the "shopping center" language with broader language based on commercial zoning. The amendment is set out below (with strikeout and underscore showing changes):

> No person shall sell or lease, or offer for sale or lease in this State any lots or parcels in a subdivision without first obtaining a public report from the Commissioner, except that the Commissioner shall waive the provisions of this section, in writing, for expressly zoned industrial subdivisions which are limited in use to industrial purposes and ~~commercial leases of parcels in a shopping center.~~
>
> ~~As used in this section, "shopping center" means a group of commercial establishments, planned, developed, owned or managed as a unit, with offstreet parking provided on the property of the shopping center~~ expressly zoned commercial subdivisions which are limited in use to commercial purposes.

See 1974 Cal. Stat. ch. 606.

Then, in 1980, the exemption was moved to its current location in Section 11010.3:

> The notice of intention specified in Section 11010 shall not be required for a proposed sale or lease of expressly zoned industrial subdivisions which are limited in use to industrial purposes and expressly zoned commercial subdivisions which are limited in use to commercial purposes.

See 1980 Cal. Stat. ch. 1336. In connection with that move, Section 11018.2 was amended to make its prohibition inapplicable to a subdivision that is not required to submit a notice of intention. *Id*. In combination, the two provisions effectively exempted subdivisions zoned commercial and industrial from the public report process.

That slightly cumbersome two-step approach was replaced, in 1982, with a simple general exemption. Section 11010.3 was amended as follows (with strikeout and underscore showing changes):

> ~~The notice of intention specified in Section 11010 shall not be required for a~~ The provisions of this chapter shall not be applicable to the proposed sale or lease of expressly zoned industrial subdivisions which are limited in use to industrial purposes and

> expressly zoned commercial subdivisions which are limited in use to commercial purposes.

See 1982 Cal. Stat. ch. 148.

Then in 1988, Section 1373 was added to the Davis-Stirling Act, with language that is functionally identical to the contemporaneous language in Section 11010.3:

> 1373. [Specified provisions of the Davis-Stirling Act] are not applicable to common interest developments that are *expressly zoned as industrial developments and limited in use to industrial purposes or expressly zoned as commercial developments and limited in use to commercial purposes.*

See 1988 Cal. Stat. ch. 123 (emphasis added to highlight common language). Because both of these provisions used largely the same language to accomplish the same end (exemption of commercial and industrial subdivisions from regulatory requirements), it is reasonable to infer that the language in Section 1373 was modeled after Section 11010.3 and that the exempt classes in these sections were intended to be identical. That inference is affirmed by Duncan McPherson, a real property attorney who has long been directly involved in legislative reform of the Subdivided Lands Act and the Davis-Stirling Act. See letter from Duncan McPherson to Brian Hebert (June 8, 2011) (on file with Commission) ("Section 1373 was enacted in 1988, and its operative language was taken from Section 11010.3.")

In 2000, Section 11010.3 was amended again, to add the language relating to restrictions in a subdivision's CC&Rs. The amendment is set out below (with strikeout and underscore to show changes):

> The provisions of this chapter shall not ~~be applicable~~ apply to the proposed sale or lease of ~~expressly industrial subdivisions which are limited in use to industrial purposes and expressly zoned commercial subdivisions which are limited in use to commercial purposes~~ lots or other interests in a subdivision in which lots or other interests are (a) limited to industrial or commercial uses by zoning or (b) limited to industrial or commercial uses by a declaration of covenants, conditions, and restrictions, which declaration has been recorded in the official records of the county or counties in which the subdivision is located.

See 2000 Cal. Stat. ch. 279. The effect of this amendment was to also exempt subdivisions that are limited to commercial and industrial uses by their recorded declarations, rather than by local zoning.

In 2003, Section 1373 was amended to incorporate the declaration language from Section 11010.3. The amended language, which was based on a Commission recommendation, read as follows:

> 1373. (a) The following provisions do not apply to a common interest development that is limited to industrial or commercial uses by zoning or by its declaration:
> …

See 2003 Cal. Stat. ch. 557; *2003-2004 Annual Report*, 33 Cal. L. Revision Comm'n Reports 569, 645-47 (2003).

That amendment was approved by the Commission in response to input from the Community Associations Institute ("CAI"), which noted the 2000 amendment of Section 11010.3 and asserted that the failure to make a parallel change to Section 1373 at the same time had been an "oversight." See Memorandum 2003-23, p. 7. That understanding was also affirmed by Duncan McPherson:

> Mr. McPherson was involved in the amendment process and reports that the failure to make a parallel change to Civil Code Section 1373 was inadvertent. Because both sections were intended to apply to the same types of developments, it would be helpful if the two sections use the same language to describe those developments. Otherwise, the differences in phrasing might imply an intended difference in meaning.

Memorandum 2004-05, p. 9.

In 2004, Section 1373 was again amended on the Commission's recommendation, and the operative language was revised to track the language in Section 11010.3 even more closely. The amendment is set out below (with strikeout and underscore to show changes):

> 1373. (a) The following provisions do not apply to a common interest development that is limited to industrial or commercial uses by zoning or by ~~its~~ a declaration of covenants, conditions, and restrictions that has been recorded in the official records of each county in which the common interest development is located:

See 2004 Cal. Stat. ch. 346; *Common Interest Development Law: Architectural Review and Decisionmaking*, 34 Cal. L. Revision Comm'n Reports 107 (2004). The Commission Comment to that provision made clear that the intention was to make Section 1373 more perfectly parallel to Section 11010.3:

> The introductory clause of subdivision (a) of Section 1373 is amended to more closely parallel the language used in Business and Professions Code Section 11010.3 (exemption of nonresidential subdivision from laws governing subdivided land).

Policy Rationales for Exemption

The staff could not find any reported case or Attorney General opinion analyzing the scope or purpose of the commercial and industrial exemption language in Civil Code Section 1373 or Business and Professions Code Section 11010.3 (or its predecessor, Business and Professions Code Section 11018.2). Nor could the staff find any DRE regulation construing the scope or purpose of the exemptions.

However, the legislative history of those provisions does shed some light on the rationale for their enactment. The staff found three main sources of useful legislative history:

(1) Contemporaneous communications relating to the enactment of Business and Professions Code Section 11018.2.
(2) Contemporaneous communications relating to the enactment of Civil Code Section 1373.
(3) A codified statement of legislative findings in Civil Code Section 1373(b).

Those sources, and their implications, are discussed below.

Enactment of Business and Professions Code Section 11018.2

The staff examined archival legislative history for AB 63 (Hayes) (1969), which enacted the original exemption language in Section 11018.2. The staff gleaned three points from that material, which are discussed below.

The Subdivided Lands Act Protects Residential Purchasers

In a letter to Governor Reagan, the author of AB 63 (Assembly Member Hayes) explained:

> Assembly Bill 63 will delete an unnecessary requirement in existing law which compels a report from the Real Estate Commissioner to complete industrial subdivisions and commercial shopping centers. This provision of the Subdivided Lands Act was placed there *when only residential subdivisions were conceived and used in California*. It is only in the past 20 years that industrial subdivisions have spread all over the State.

See Exhibit p. 1 (emphasis added).

This suggests that the original purpose of the Subdivided Lands Act was solely to protect residential property purchasers. Once it became evident that the Subdivided Lands Act was also being applied to nonresidential subdivisions, the exemption was enacted to restore the original purpose and scope of the Act — the protection of residential purchasers.

A Department of Finance analysis of the bill also asserts that the purpose of the Subdivided Lands Act was to protect *residential* purchasers:

> According to the Department of Real Estate purchasers and lessees in industrial subdivisions and shopping centers normally do not require the protection required by the [Subdivided] Lands Act *which is designed primarily for residential subdivisions*. The Department indicates that the reports required to be issued by the department on industrial subdivisions and shopping centers are of little use.

See Exhibit p. 4 (emphasis added).

Business Property Purchasers are More Sophisticated than Residential Purchasers

Both of the sources quoted above maintain that business property purchasers do not need regulation under the Subdivided Lands Act. A letter from the California Real Estate Association to Governor Reagan offers some explanation of why that might be:

> the buyer or lessee in [an industrial subdivision or commercial shopping center] can be considered to be a *more sophisticated individual not requiring the wealth of detail provided the residential home buyer* in the Commissioner's public report.

See Exhibit p. 6 (emphasis added). This is the first appearance of a policy assumption that will later be repeated in the history of Section 1373 and is discussed more fully below: business property owners are more sophisticated than residential property owners and do not require the same level of regulatory protection.

Practical Objections to Regulation of Business Property

The legislative history also states practical reasons why regulation of business subdivisions under the Subdivided Lands Act could either be problematic or unhelpful:

- The California Real Estate Association asserted that it is not possible for business properties to provide all of the information required as part of the public report process, because of the way in

which business subdivisions are constructed (with some infrastructure decisions deferred until after the sale or lease of parcels or lots). See Exhibit pp. 5-6.

- Assembly Member Hayes asserted that business subdivisions are adequately regulated under the Subdivision Map Act, making much of the Subdivided Lands Act requirements unnecessary. See Exhibit pp. 1-2.
- The DRE asserted, without specific explanation, that "public reports issued on industrial subdivisions and shopping centers are many times awkward and of nominal utility." See Exhibit p. 3.

Enactment of Civil Code Section 1373

The legislative history of the enactment of Civil Code Section 1373 provides more insight into the policy rationale for the commercial and industrial exemption language. That history has been discussed in prior memoranda, in the separate study of the proper application of the Davis-Stirling Act to commercial and industrial CIDs. See, e.g., Memorandum 2008-63.

A Senate Floor Analysis of the bill that added Section 1373 (1988 Cal. Stat. ch. 123) states:

> 1. Commercial and industrial common interest developments are business endeavors in which the parties engage the professional services of attorneys, accountants, management companies, and developers. Unlike groups of neighbors providing for the governance of their living conditions, these business people are well informed and governed by other provisions of commercial law.
>
> 2. The operational needs of commercial and industrial common interest developments are different than those of a residential association, e.g., "An individual business owner's assessment may increase disproportionately, but fairly, in a given assessment period based on business expansion, change of use, or other negotiated factors, such as an extrahazardous use which raises insurance premiums."
>
> 3. Business parks often add amenities and new facilities as the park is developed. Increased assessments are needed in a timely manner to pay for improvements. Unlike residential owners, business owners pass these increased costs on to their owners.
>
> 4. Regulatory requirements designed to protect individuals in residential developments are inappropriate in business developments, interfere with commerce, and increase the costs of doing business.

Senate Floor Analysis of AB 2484 (Hauser) (May 18, 1988), pp. 2-3.

As can be seen, that analysis echoes many of the themes that appeared in the materials discussing the 1969 amendment of Section 11018.2:

(1) The purpose of the regulation is to protect residential property owners.
(2) Business property owners are more sophisticated than residential owners, with greater access to professional assistance, and do not need regulatory protection.
(3) There are practical reasons why regulation of business property owners would be an inappropriate burden on business operations.

In addition, a letter from the California Building Industry Association to Assembly Member Hauser reinforces the first point, stating: "the Act was primarily enacted for the purpose of regulating residential developments." See Memorandum 2008-63, Exhibit p. 1.

Finally, there are two sources suggesting that the Davis-Stirling Act was not originally intended or expected to have *any* application to nonresidential CIDs (i.e., it was only expected to regulate residential CIDs). See letter from Jerold L. Miles to Michael Krisman (aide to Assembly Member Dan Hauser) (Sept. 16, 1986) (on file with Commission); Office of Local Government Affairs, Enrolled Bill Report on AB 2484 (May 23, 1988) (on file with Commission).

Statement of Legislative Findings

Section 1373(b) provides an express statement of legislative findings, which sheds further light on the policy rationale for the exemption of commercial and industrial CIDs from portions of the Davis-Stirling Act:

> 1373. …
> (b) The Legislature finds that the [provisions declared inapplicable to commercial or industrial CIDs] are appropriate to protect purchasers in residential common interest developments, however, the provisions may not be necessary to protect purchasers in commercial or industrial developments since the application of those provisions could result in unnecessary burdens and costs for these types of developments.

This again reinforces the notion that the purpose of the Davis-Stirling Act regulations was to "protect purchasers in residential common interest developments." Business property owners may not need those protections and may be adversely burdened by them.

Residential v. Nonresidential

The legislative history discussed above includes a number of statements indicating that the Subdivided Lands Act and the Davis-Stirling Act were originally enacted to protect *residential* purchasers. Each time that the Legislature learned that these laws were being applied to a type of *nonresidential* property, it exempted that type of property.

In addition, the legislative history contains a number of statements drawing a distinction between residential property owners on the one hand, and commercial or industrial property owners on the other.

Why does this matter? Because, it suggests that the Legislature may have intended to establish a dichotomy between residential property (which should be regulated) and nonresidential property (which should not be regulated).

If that is correct, then the exemption language was framed in the wrong way. By adding affirmative exemptions for *specific types* of nonresidential property, the Legislature was running the risk that *other types* of nonresidential property might exist, that would not fit within the scope of the narrowly framed exemption language.

That seems to be what happened. At first the exemption only applied to property that was zoned industrial and "shopping centers." Then the exemption was broadened to include other property that is zoned commercial. Then the exemption was broadened again, to include property that is limited to commercial or industrial use by its recorded declaration, rather than by zoning.

Now commenters have pointed out that there are still *other* types of nonresidential property (e.g., a storage condominium) that do not fit within the existing exemption. They are proposing that the existing exemption be expanded again, to exempt those additional types of nonresidential property. (This issue is discussed more fully below.)

If the Legislature's intent in enacting and modifying Sections 1373 and 11010.3 was to create a dichotomy between *residential* property and *nonresidential* property (without regard for the type of nonresidential property), then the exemption language should probably state that distinction directly. **Rather than rely on an affirmative list of specific nonresidential property types, the exemption language could simply exempt all nonresidential subdivisions (i.e., those that cannot contain residences).**

That would seem to eliminate the risk of unintended gaps in the exemption, resulting from the existence of unanticipated types of nonresidential property.

Caveat

There are two provisions of the Subdivided Lands Act that are expressly limited, by their terms, to *residential* subdivisions. See Bus. & Prof. Code §§ 11010.11 (in residential subdivision, public report must disclose buyer's right to negotiate regarding inspections), 11018(f) (in residential subdivision, vehicular access and potable domestic water must be available). Both of those provisions were added after enactment of the commercial and industrial exemption language. See 2001 Cal. Stat. ch. 307 and 1971 Cal. Stat. ch. 1686, respectively.

The fact that the Legislature expressly restricted these provisions to residential subdivisions suggests that the Legislature may have understood the Subdivided Lands Act to apply to some *nonresidential* property types. Otherwise, the restrictions would be unnecessary.

On the other hand, it is possible that the authors of the two provisions were simply focused on adding specific protections for homeowners, and did not consider whether it was legally necessary to restrict the provisions to residential property. Or the references to residential property may have been added as a matter of emphasis, either to reassure residential property interests that they would be protected or to reassure nonresidential property owners that they wouldn't be burdened. Unfortunately, the staff did not find any relevant legislative history on this issue.

However, the legislative analyses of the bill that added Section 11010.11 do explain why residential property requires regulation that is not needed for other property:

> According to the sponsors, the purchase of a home is usually the largest investment a person makes in his or her life. With so much money involved, it becomes imperative for the buyer to make an informed decision.

Id. at 2.

ANALYSIS OF POSSIBLE AMENDMENTS TO EXEMPTION LANGUAGE

The Commission is currently studying the application of the Davis-Stirling Act to commercial and industrial CIDs. That study is focused on determining which provisions of the Davis-Stirling Act should be covered by the exemption provided in Civil Code Section 1373. See Tentative Recommendation on *Commercial and Industrial Common Interest Developments* (February 2011). In that

study, the Commission has not recommended any substantive change to the class of CIDs that are entitled to the exemptions. *Id.*

In response to that tentative recommendation, the Commercial CID Stakeholder Group suggested that Section 1373 be revised to refine the commercial and industrial exemption language. See Memorandum 2011-21 and its First and Second Supplements.

The group was concerned that the existing language does not clearly encompass two unusual types of CIDs:

(1) CIDs that are not residential, commercial, or industrial.
(2) CIDs in which a separate interest is used by its owner as residential rental property.

Id. Those two special cases are discussed more fully below.

Nonresidential Personal-Use Subdivisions

The Commercial CID stakeholder Group notes that there are some unusual types of CIDs that are not residential *but are also not commercial or industrial*. Examples include:

(1) A marina in which the separate lots or interests are boat slips.
(2) A "storage condominium" in which the separate lots or interests are storage units.
(3) A "parking condominium" in which the separate lots or interests are parking spaces.

For convenience, this memorandum will refer to these types of subdivisions as "nonresidential personal-use subdivisions." (This does not include a subdivision in which boat slips, storage units, parking spaces, or other amenities are owned as appurtenances to residential property.)

Should nonresidential personal-use subdivisions be exempted from the Subdivided Lands Act and portions of the Davis-Stirling Act, in the same way as commercial or industrial subdivisions?

There are two main prongs to the policy rationale for the existing commercial and industrial exemptions:

(1) The Davis-Stirling Act and the Subdivided Lands Act were enacted to protect residential property owners.
(2) Business property owners are different in character from residential owners and do not need (and may be adversely burdened by) regulation under those Acts.

The relevance of those rationales to nonresidential personal-use subdivisions is discussed below.

Regulation Intended to Protect Residential Owners Only

As noted above, the legislative history suggests that the Davis-Stirling Act and the Subdivided Lands Act were enacted with the intention of protecting residential property owners. It appears that, at the time of enactment, the Legislature did not anticipate that the Acts would apply to any nonresidential property. Each time the Legislature became aware of such application, it created or expanded exemptions to narrow the scope of application.

A focus on regulating residential property makes sense as a matter of policy. A person's residence is a uniquely important asset. It is likely to be the largest investment most homeowners will make. It is reasonable for the Legislature to regulate residential subdivisions in order to protect the value and stability of an owner's home.

The Davis-Stirling Act does so by regulating the budget and reserve funding process, requiring the transparency of financial records, and limiting foreclosure for overdue assessments. The Subdivided Lands Act does so by protecting purchasers against fraud, requiring that title be clear of any blanket encumbrance, and requiring that a subdivider demonstrate that there are reasonable arrangements for the completion and maintenance of the promised facilities.

In addition to being a uniquely important financial investment, residential property is typically also the owner's *home*. Problems with the enforcement of property use restrictions or with the operation of the governing association can lead to divisive conflicts that degrade the quality of life within a subdivision. Again, it is reasonable for the Legislature to regulate property to minimize such problems.

The Davis-Stirling Act does so by creating opportunities for informal dispute resolution, requiring minimal due process when an association makes a decision affecting an individual homeowner (e.g., discipline, architectural review, foreclosure), and requiring specified member assent to certain types of governance decisions. The Subdivided Lands Act does so by requiring that a CID's original governing documents include "reasonable arrangements" on a wide range of self-governance issues.

These sorts of policy concerns do not seem relevant to a nonresidential personal-use subdivision. A parking space, storage unit, or boat slip is unlikely to be a person's largest financial investment, deserving of special regulatory protection. Nor is it likely to be the person's home, requiring regulation to ensure fair and participatory self-governance and informal dispute resolution opportunities.

On the basis of the foregoing analysis, the staff does not see a compelling need for the Davis-Stirling Act and Subdivided Lands Act to regulate nonresidential personal-use subdivisions. Such CIDs do not share the special character of residential property that justifies regulation.

Regulation of Business Property

Part of the rationale for the existing commercial and industrial exemptions is grounded in the special character of business property owners. The legislative history tells us that business property owners have access to attorneys and accountants, and have greater sophistication than residential owners. That is not necessarily true of a person who buys a storage locker, parking space, or boat slip for their personal use.

The legislative history also tells us that business property owners are adequately regulated by general commercial law. Again, this is not true of an owner in a nonresidential personal-use subdivision. A person who purchases a boat slip is not subject to general business regulation.

Finally, the legislative history cites practical reasons why regulation under the Davis-Stirling Act and Subdivided Lands Act may be inappropriate for business property and may unduly interfere with commerce. Those concerns do not seem relevant to a nonresidential personal-use subdivision, which is not used by its owners to operate businesses.

As can be seen, these special concerns about regulating business property do not seem to provide any support for exempting nonresidential personal-use subdivisions from regulation.

Special Note on Cemeteries

There is commentary in a respected California real property treatise, asserting that cemeteries should be considered "commercial or industrial" for the purposes of Business and Professions Code Section 11010.3, so that the sale of plots in cemeteries is exempt from the Subdivided Lands Act. See Miller, Starr &

Regalia, California Real Estate *Subdivision Offerings, Sales, and Leasing* § 25C:11 at 25C44-45 (2007 Update).

This demonstrates that there are yet other types of nonresidential personal-use subdivisions, beyond those noted by the Commercial CID Stakeholder Group. This illustrates the value of framing the exemption in terms of the presence or absence of residences, rather than trying to anticipate and affirmatively list every type of nonresidential use. It is too easy to overlook some unusual type of nonresidential use.

Note also that the treatise asserts that the Subdivided Lands Act has never been applied to the sale of cemetery plots, "despite the omission of any express exemption in the Act." *Id*. This suggests that the DRE may view the Subdivided Lands Act as applying only to residential property, notwithstanding the current language of the commercial and industrial exemption.

Possible Amendments

As discussed above, there does not seem to be a compelling need to regulate nonresidential personal-use subdivisions under the Davis-Stirling Act and the Subdivided Lands Act. That said, the special concerns about regulation of business property do not necessarily weigh against such regulation.

Bear in mind, however, that regulation is not cost-free. The Davis-Stirling Act imposes complex governance procedures that drive up administration costs for owners of CIDs, and the Subdivided Lands Act imposes process costs on both subdividers and the DRE.

With the preceding considerations in mind, the Commission needs to decide whether nonresidential personal-use subdivisions should be included within the scope of the existing exemptions.

If the Commission decides to expand the exemptions in that way, the staff recommends using the drafting approach discussed earlier (i.e., exempt all "nonresidential" subdivisions, rather than adding nonresidential personal-use subdivisions to a list of specific nonresidential subdivision types). Thus:

> **Bus. & Prof. Code § 11010.3 (amended). Nonresidential subdivisions**
>
> 11010.3. (a) The provisions of this chapter shall not apply to the proposed sale or lease of lots or other interests in a nonresidential subdivision ~~in which lots or other interests are (a) limited to industrial or commercial uses by zoning or (b) limited to industrial or commercial uses by a declaration of covenants, conditions, and~~

~~restrictions, which declaration has been recorded in the official records of the county or counties in which the subdivision is located~~.

(b) For the purposes of this section, a subdivision is "nonresidential" if either of the following conditions is satisfied:

(1) The law, including any statute, ordinance, regulation, or permit, prohibits any residential use within the subdivision.

(2) A declaration of covenants, conditions, and restrictions that has been recorded in the official records of each county in which the subdivision is located prohibits any residential use within the subdivision.

Comment. Section 11010.3 is amended to expressly extend the exemption provided by the section to any subdivision in which residential use is prohibited by the law or by a recorded declaration of covenants, conditions, and restrictions.

Civ. Code § 1373 (amended). Nonresidential common interest development

1373. (a) The following provisions do not apply to a nonresidential common interest development ~~that is limited to industrial or commercial uses by zoning or by a declaration of covenants, conditions, and restrictions that has been recorded in the official records of each county in which the common interest development is located~~:

…

(c) For the purposes of this section, a common interest development is "nonresidential" if either of the following conditions is satisfied:

(1) The law, including any statute, ordinance, regulation, or permit, prohibits any residential use within the common interest development.

(2) A declaration of covenants, conditions, and restrictions that has been recorded in the official records of each county in which the common interest development is located prohibits any residential use within the common interest development.

Comment. Section 1373 is amended to expressly extend the exemption provided by the section to any common interest development in which residential use is prohibited by the law or by a recorded declaration of covenants, conditions, and restrictions.

There are three things worth noting about the proposed language:

(1) As with existing law, an express limitation would be required for the exemption to apply. The mere absence of residences would not be sufficient.

(2) As with existing law, even a single residence would be sufficient to take a subdivision out of the exempted class.

(3) The proposal would replace the reference to "zoning" with a broader reference to any law that prohibits residential use. This would help to avoid any gap that might otherwise exist if a law other than a zoning ordinance prohibits residential use of a subdivision (e.g., a statute prohibiting residential use of certain contaminated property).

Should changes along the lines described above be included in a tentative recommendation?

Rental of Residences as Commercial Use

The other concern raised by the Commercial CID Stakeholder Group involves a CID in which a single separate interest includes multiple residences, with the owner of the separate interest renting those residences to third parties as a business. For example, an entire apartment building might be structured as one separate interest within a CID, with the owner of the separate interest acting as a landlord for the apartments contained within the separate interest. For ease of reference, the remainder of this memorandum will refer to this type of use as the operation of an apartment building.

Should the use of a lot or parcel to operate an apartment building be considered a "commercial use" of the lot or parcel, notwithstanding the fact that the commercial activity involved is the leasing of *residences*?

Again, the two main policy rationales for the existing exemptions are as follows:

(1) The Davis-Stirling Act and the Subdivided Lands Act were enacted to protect residential property owners.
(2) Business property owners are different in character from residential owners and do not need (and may be adversely burdened by) regulation under those Acts.

The implications of those policies differ depending on whether one focuses on the property *owner* or the owner's *tenants*.

Implications Relating to the Owner

With respect to the *owner* of a lot or parcel that is operated as an apartment building, the use of that property seems to be a commercial use. The owner is using the property to operate a business and is in the same position and has the same character as other owners operating businesses within the subdivision.

An owner operating an apartment building does not need the regulatory protections afforded to homeowners. The property is not the owner's home; it is business property. Consequently, policy concerns about protecting homeowners' investments and promoting convivial living conditions for homeowners do not seem to be relevant.

Furthermore, the assumptions that a business property owner has greater professional resources and is more sophisticated than a typical homeowner would seem to apply equally to an owner who is operating an apartment building. It may also be true that the operation of an apartment building is already adequately regulated by general commercial law (including landlord-tenant law) and there may be practical reasons why regulation of such a business under the Davis-Stirling Act and Subdivided Lands Act would unduly interfere with commerce.

Therefore, all of the policies that justify exempting commercial property from regulation under the Subdivided Lands Act and portions of the Davis-Stirling Act seem to apply with equal force to an *owner* who is using subdivision property to operate an apartment building.

Implications Relating to the Owner's Tenants

As discussed above, it is reasonable to conclude that an owner who is operating an apartment building in a subdivision lot or parcel is making commercial use of that property. However, it is also true that the owner's *tenants* are using their portions of the property as *residences*.

Given that the primary purpose of the Davis-Stirling Act and the Subdivided Lands Act is to regulate residential property within subdivisions, should those Acts be applied to a lot or parcel that is used to operate an apartment building, in order to benefit the owner's tenants?

Recall that the Subdivided Lands Act regulates both sales *and leases* of lots or parcels within a subdivision. See Bus. & Prof. Code § 11018.2. This suggests that the Act is intended to benefit some lessees.

However, the Subdivided Lands Act includes an express exemption for "the leasing of apartments … within an apartment building …" (with an exception for community apartment projects, which are a type of CID where the "lease" is appurtenant to an undivided interest in the CID property as a whole). See Bus. & Prof. Code § 11000(a).

By adding that exemption, the Legislature seems to have made clear that the Subdivided Lands Act is not concerned with regulating general landlord-tenant relations.

Furthermore, the staff does not see any way in which the provisions of the Subdivided Lands Act would benefit or protect an owner's tenants. The provisions of the Act regulate the transaction between the *subdivider* and purchasers or lessees of lots or parcels within the subdivision. A tenant of an owner is not a party to the transaction with the subdivider.

In light of the foregoing, the staff does not believe that the Subdivided Lands Act was intended to protect a purchaser's tenants, nor does it have such an effect as a practical matter. **Therefore, the fact that tenants are themselves making residential use of a lot or parcel that is operated as an apartment building does not seem to provide any good reason for applying the Subdivided Lands Act to an otherwise entirely commercial subdivision.**

The same seems to be true of the Davis-Stirling Act. Its provisions are almost entirely limited to regulating and protecting the *owners* of separate interests within a common interest development. The Act's provisions can be roughly broken down into the following types:

(1) Provisions that establish the character of an *owner's* property interest in a CID.
(2) Provisions establishing procedures for the amendment and enforcement of governing documents by the *owners*.
(3) Provisions that regulate the operation of the *owners'* association, and guarantee *owner* participation in governance procedures.
(4) Provisions governing an *owner's* obligation to pay assessments and regulating assessment collection procedures.
(5) Provisions guaranteeing specified property uses by an *owner*. There is nothing in these provisions that prevents an owner restricting a tenant's property use.

There are only two significant protections afforded directly to tenants by the Davis-Stirling Act:

- The occupants of a separate interest must receive notice before being required to vacate for termite abatement purposes. See Civ. Code § 1364(d)(2).
- No occupant of a separate interest can be denied physical access to the separate interest. See Civ. Code § 1361.5.

Importantly, c*ommercial and industrial CIDs are not exempt from those two provisions* (nor would they be made exempt by the Commission's current proposal regarding Section 1373). Consequently, those two provisions apply to *all* CIDs, regardless of whether they are included within the scope of the exempted class.

Therefore, the fact that tenants are themselves making residential use of a separate interest that is operated as an apartment building does not seem to provide any good reason for applying the entire Davis-Stirling Act to an otherwise entirely commercial CID.

Possible Amendments

If the Commission concludes that the operation of an apartment building in a lot, parcel, or separate interest is a commercial use that should be exempt from regulation under the Subdivided Lands Act and portions of the Davis-Stirling Act, that could be achieved by amending Business and Professions Code Section 11010.3 and Civil Code Section 1373.

The exact form of the implementing amendments will vary, depending on whether the Commission also decides to include nonresidential personal-use subdivisions within the exempted class. For that reason, two alternative sets of amendments are proposed below.

Proposed Amendments if Nonresidential Personal-Use Subdivisions are Exempted

If the Commission decides to include nonresidential personal-use subdivisions within the exempted class, then the language proposed earlier to achieve that result would need to be modified so as to also include the operation of an apartment building within the exempted class. Proposed language is set out below (with the amendments presented on pages 25-26 shown in strikeout and underscore, and the new language shown in italics):

> **Bus. & Prof. Code § 11010.3 (amended). Nonresidential subdivisions**
>
> 11010.3. (a) The provisions of this chapter shall not apply to the proposed sale or lease of lots or other interests in a nonresidential subdivision ~~in which lots or other interests are (a) limited to industrial or commercial uses by zoning or (b) limited to industrial or commercial uses by a declaration of covenants, conditions, and restrictions, which declaration has been recorded in the official records of the county or counties in which the subdivision is located~~.

(b) For the purposes of this section, a subdivision is a "nonresidential subdivision" if either of the following conditions is satisfied:

(1) The law, including any statute, ordinance, regulation, or permit, prohibits any residential use within the subdivision.

(2) A declaration of covenants, conditions, and restrictions that has been recorded in the official records of each county in which the subdivision is located prohibits any residential use within the subdivision, *other than the use of a lot or parcel as residential rental property*.

Comment. Section 11010.3 is amended to expressly extend the exemption provided by the section to any subdivision in which residential use is prohibited by the law or by a recorded declaration of covenants, conditions, and restrictions.

Under paragraph (b)(2), the use of a lot or parcel as residential rental property does not preclude the subdivision from being a "nonresidential subdivision" within the meaning of the section.

Civ. Code § 1373 (amended). Nonresidential common interest development

1373. (a) The following provisions do not apply to a nonresidential common interest development ~~that is limited to industrial or commercial uses by zoning or by a declaration of covenants, conditions, and restrictions that has been recorded in the official records of each county in which the common interest development is located~~:

…

(c) For the purposes of this section, a common interest development is "nonresidential" if either of the following conditions is satisfied:

(1) The law, including any statute, ordinance, regulation, or permit, prohibits any residential use within the common interest development.

(2) A declaration of covenants, conditions, and restrictions that has been recorded in the official records of each county in which the common interest development is located prohibits any residential use within the common interest development, *other than the use of a separate interest as residential rental property*.

Comment. Section 1373 is amended to expressly extend the exemption provided by the section to any common interest development in which residential use is prohibited by the law or by a recorded declaration of covenants, conditions, and restrictions.

Under paragraph (c)(2), the use of a separate interest as residential rental property does not preclude the common interest development from being a "nonresidential common interest development" within the meaning of the section.

Implementing Amendments if Nonresidential Personal-Use Subdivisions are not Exempted

If the Commission decides *against* including nonresidential personal-use subdivisions within the exempted class, then the following amendments could be used to make clear that the operation of an apartment building is a commercial use:

Bus. & Prof. Code § 11010.3 (amended). Commercial or industrial subdivisions

11010.3. (a) The provisions of this chapter shall not apply to the proposed sale or lease of lots or other interests in a commercial or industrial subdivision ~~in which lots or other interests are (a) limited to industrial or commercial uses by zoning or (b) limited to industrial or commercial uses by a declaration of covenants, conditions, and restrictions, which declaration has been recorded in the official records of the county or counties in which the subdivision is located~~.

(b) For the purposes of this section, a subdivision is a "commercial or industrial subdivision" if either of the following conditions is satisfied:

(1) The law, including any statute, ordinance, regulation, or permit, limits the subdivision to commercial and industrial uses.

(2) A declaration of covenants, conditions, and restrictions that has been recorded in the official records of each county in which the subdivision is located limits the subdivision to commercial and industrial uses. For the purposes of this paragraph, the use of a lot or parcel as residential rental property is a "commercial use" of the lot or parcel.

Comment. Section 11010.3 is amended to make clear that the use of a lot or parcel as residential rental property does not preclude the subdivision from being a "commercial or industrial subdivision" within the meaning of the section.

Civ. Code § 1373 (amended). Commercial or industrial common interest development

1373. (a) The following provisions do not apply to a commercial or industrial common interest development ~~that is limited to industrial or commercial uses by zoning or by a declaration of covenants, conditions, and restrictions that has been recorded in the official records of each county in which the common interest development is located~~:

…

(c) For the purposes of this section, a common interest development is a "commercial or industrial common interest development" if either of the following conditions is satisfied:

(1) The law, including any statute, ordinance, regulation, or permit, limits the common interest development to commercial and industrial uses.

(2) A declaration of covenants, conditions, and restrictions that has been recorded in the official records of each county in which the common interest development is located limits the common interest development to commercial and industrial uses. For the purposes of this paragraph, the use of a separate interest as residential rental property is a "commercial use" of the separate interest.

Comment. Section 1373 is amended to make clear that the use of a separate interest as residential rental property does not preclude the common interest development from being a "commercial or industrial common interest development" within the meaning of the section.

Another Alternative: Preserve Existing Law

Another possibility would be to make no change to the existing exemption language. That approach has the advantage of avoiding any unforeseen consequences that might arise from making a change.

However, preserving existing law could have significant disadvantages as well. For example:

- Suppose that a subdivider believes that the Subdivided Lands Act does not apply to a particular subdivision (e.g., a marina) and sells lots without applying for a public report. A complaint is filed with the DRE and the DRE concludes that the Subdivided Lands Act applies. The subdivider could be prosecuted for a misdemeanor. See Bus. & Prof. Code § 11023.
- Alternatively, suppose that the subdivider applies for a public report for a marina, but the DRE returns the application with a letter stating that the Subdivided Lands Act does not apply. Later a purchaser of a lot in the marina is dissatisfied and sues for rescission and damages, arguing that DRE's interpretation was incorrect and the sale was unlawful.
- If the Commission's recommendation to establish separate bodies of law for residential CIDs and commercial and industrial CIDs is enacted, it will be important that the definition used to determine the applicable statute be very clear. Any ambiguity could produce significant errors and litigation.
- Finally, suppose that a subdivision is limited to nonresidential uses by a law other than a zoning ordinance. Is that property subject to the exemption? Uncertainty on that point could lead to the problems noted above.

For the reasons stated above, it is important that the exemption language provide a bright line standard. Any ambiguity could lead to costly errors, litigation, and even potential criminal liability. **The staff recommends against preserving the existing language.**

CONCLUSION

The legislative history of the commercial and industrial exemption language suggests four things about its intended scope and purpose:

(1) The exemption provisions in Sections 1373 and 11010.3 were developed in parallel, over a span of years, with the apparent intention that the exempted class be the same for each.
(2) The primary purpose of the Davis-Stirling Act and the Subdivided Lands Act is to regulate and protect residential property.
(3) Business property owners are assumed to be more sophisticated than residential property owners and have greater access to professional assistance. They do not require the sorts of protections offered by the Davis-Stirling Act and the Subdivided Lands Act. They are already adequately regulated by general commercial law.
(4) There are practical reasons why regulation of business property by the Davis-Stirling Act and the Subdivided Lands Act are unhelpful and would impose undue burdens on commercial activity.

The Commission now needs to decide whether to propose changes to the exemption language as discussed earlier in the memorandum. If so, the staff will prepare a draft of a tentative recommendation that includes whatever proposal the Commission provisionally approves.

Before the Commission meets to consider this matter, the staff hopes to meet informally with representatives of the Department of Real Estate and the Commercial CID stakeholder Group. If that meeting occurs, the staff will report on the results, either orally or in a supplement to this memorandum.

Respectfully submitted,

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Assembly
California Legislature

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JUDICIAL COUNCIL OF CALIFORNIA
SELECT COMMITTEE ON THE ADMINISTRATION OF JUSTICE
CALIFORNIA COUNCIL ON CRIMINAL JUSTICE
JOINT LEGISLATIVE COMMITTEE ON PUBLIC DOMAIN

JAMES A. HAYES
ASSEMBLYMAN, THIRTY-NINTH DISTRICT
LONG BEACH-SIGNAL HILL
CHAIRMAN
ASSEMBLY COMMITTEE ON JUDICIARY

June 27, 1969

Honorable Ronald Reagan
Governor of California
State Capitol
Sacramento, California

Re: Assembly Bill 63

Dear Governor Reagan:

I urgently request your signature on Assembly Bill 63, now on your desk.

Assembly Bill 63 will delete an unnecessary requirement in existing law which compels a report from the Real Estate Commissioner to complete industrial subdivisions and commercial shopping centers. This provision of the Subdivided Lands Act was placed there when only residential subdivisions were conceived and used in California. It is only in the past 20 years that industrial subdivisions have spread all over the State.

All of the information called for is already required to be given under the provisions of the Subdivision Map Act. This requirement is for a report which includes a listing of the encumbrances, detailed engineering plans, and the condition of title. We are not changing this requirement of existing law. Neither is there a change in the requirement that local government must give complete approval through its planning, building, and zoning departments.

It is the routine processing of duplicate papers already filed under the Subdivision Map Act that we are eliminating. Papers that call for a report which serves no useful purpose but which has caused a loss of many potential business tenants because of the six to eight weeks delay required to process the unnecessary report.

EX 1

The public is totally protected. In practice, industrial subdivision developers, and shopping center developers have complete examinations made and the prospective tenants have examinations made by soil engineers, architects, contractors, and lawyers. The small lots, less than a subdivision, are not affected by AB 63 at all.

This bill is supported by the State Chamber of Commerce, numerous area chambers, including Los Angeles, the Division of Real Estate, and has had no opposition in the Assembly or the Senate.

Respectfully,

JAMES A. HAYES

JAH:slm

EX 2

ENROLLED BILL REPORT

AGENCY	BILL NUMBER
Business and Transportation Agency	A.B. 63
DEPARTMENT, BOARD OR COMMISSION	**AUTHOR**
~~Department of Public Works~~ Department of Real Estate	Hayes

Sponsored by the State Chamber of Commerce.

Identical bill introduced in 1968 (S.B. 422), sponsored by Real Estate Commissioner, died in Senate Finance Committee.

Requires Real Estate Commissioner to waive subdivision public reports for expressly zoned industrial subdivisions which are limited in use to industrial purposes, and commercial leases of parcels in a shopping center.

Subdivision public reports issued on industrial subdivisions and shopping centers are many times awkward and of nominal utility. Purchasers and lessees in industrial subdivisions and shopping centers normally do not require the protection afforded by the Subdivision Lands Act.

Supported by the Real Estate Commissioner, California Real Estate Association, California Land Title Association, the California Railroad Association, and numerous other organizations.

The bill was unopposed.

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RECOMMENDATION			
Governor sign.			
DEPARTMENT HEAD	DATE	AGENCY HEAD	DATE
	6/25/69		6/26

ENROLLED BILL REPORT

(Form LD-5 1M

AGENCY	BILL NUMBER
DEPARTMENT OF FINANCE	AB 63
DEPARTMENT, BOARD OR COMMISSION: Department of Finance	AUTHOR: Hayes

SUMMARY:

[Requires the Real Estate Commissioner to waive, in writing, expressly zoned industrial subdivisions which are limited in use to industrial purposes and commercial leases of parcels in a shopping center from the requirement of obtaining a public report prior to sale, lease, or offering for sale of any lot or parcel in a subdivision.]

HISTORY, SPONSORSHIP AND RELATED LEGISLATION:

According to the Department of Real Estate purchasers and lessees in industrial subdivisions and shopping centers normally do not require the protection required by the Subdivision Lands Act which is designed primarily for residential subdivisions. The Department indicates that the reports required to be issued by the Department on industrial subdivisions and shopping centers are of little use.

ANALYSIS:

FINANCIAL EFFECT:

This bill would have minimal financial effect. It would probably reduce slightly the workload in the Department of Real Estate and it would reduce slightly (less than 1 percent) the amount of subdivision fees collected as revenue to the Real Estate Fund.

RECOMMENDATION

Sign the bill.

DEPARTMENT REPRESENTATIVE	DATE	DIRECTOR	DATE
K West			

EX 4

CALIFORNIA REAL ESTATE ASSOCIATION
and California Real Estate Magazine

Telephone
(AREA CODE 213) 628-0551

EXECUTIVE OFFICES
520 SOUTH GRAND AVE.
LOS ANGELES, CALIF. 90017

11th and L Building, Suite 503
Sacramento, California 95814
June 24, 1969

The Honorable Ronald Reagan, Governor
State of California
State Capitol
Sacramento, California 95814

Attention: Senator Vernon Sturgeon
Legislative Secretary

Subject: AB 63 (Hayes)

Dear Governor Reagan:

This measure has now passed the Legislature without opposition and has been forwarded to you for consideration. The California Real Estate Association supports this bill and asks your favorable consideration of it.

The present Subdivided Lands Act requires that the Commissioner of Real Estate issue a public report on every subdivision (this should not be confused with the Subdivision Map Act which establishes local controls over physical arrangement of subdivisions). This bill permits the Commissioner to waive the requirement of a public report for expressly zoned industrial subdivisions limited to industrial purposes and commercial leases of parcels in shopping centers. Obviously, in each case an application for waiver must be submitted to the Commissioner and he, therefore, has an opportunity to review whether the prospective subdivision qualifies for the waiver or not.

Because of the nature of industrial subdivisions and shopping centers, it is not possible at the time of their initiation to provide all the data contemplated in the normal public report situation. For example,

EX 5

the location of streets and utilities will be determined only after sales or leases have been completed rather than before the solicitation of sales as would occur in the typical residential situation. Thus, the public report for an industrial subdivision or leased shopping center loses much of its significance.

Furthermore, the buyer or lessee in such situations can be considered to be a more sophisticated individual not requiring the wealth of detail provided the residential home buyer in the Commissioner's public report.

This bill has been supported by the Department of Real Estate and, in fact, a similar measure was part of your legislative program in 1968 but failed to gain passage through the legislature. The bill this year is sponsored by the California State Chamber of Commerce.

If there are any questions on it, we would be most pleased to try to provide additional information. Your signature on the bill would be appreciated.

Sincerely,

Dugald Gillies
Legislative Representative

DG/bl
cc: The Honorable James Hayes
Member of the Assembly
The Honorable Burton E. Smith
Commissioner of Real Estate
h. Jackson Pontius

EX 6